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CONSUMERS ILLINOIS WATER COMPANY)
Petition for (1) issuance of a Certificate of Public)
Convenience and Necessity ("Certificate") to)
operate a water supply and distribution system and)
sewage collection system in Lake County;)
(2) approval of accounting entries related to)
acquisition of facilities; (3) approval for application)
of rates.)

Docket 00-0366

REPLY BRIEF OF CONSUMERS ILLINOIS WATER COMPANY

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STATE OF ILLINOIS

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REPLY BRIEF OF CONSUMERS ILLINOIS WATER COMPANY

I. INTRODUCTION

This is the Reply of Consumers Illinois Water Company ("CIWC" or the "Company") to the "Initial Brief of the Staff of the Illinois Commerce Commission" ("Initial Brief" or "Staff's Brief") filed on December 21, 2000.

In its Initial Brief (pp. 4-6), Staff notes correctly that, in this proceeding, certain matters are uncontested: (i) CIWC's request for issuance of a Certificate; (ii) the proposal to adopt initially for Ivanhoe Club¹ the water and sewer rates in effect in the Village²; (iii) the proposal that, for the first ten years following the Acquisition, rate filings submitted by CIWC to implement new water or sewer rates set by the Village should not be automatically suspended, but should instead be evaluated in light of information provided by CIWC with the proposed new Village rates and in the Reports discussed in CIWC's Initial Brief; and (iv) the proposal that the

¹ Unless otherwise indicated, the abbreviations used by CIWC in this Reply Brief are the same as those used in CIWC's Initial Brief.

² In its Brief (p. 4), Staff suggests that tariffs adopting the Village rates should be filed within five days of the Order issued in this proceeding. CIWC does not object to this proposal but notes that the Order and tariffs should indicate that such tariffs would take effect upon closing of the Acquisition.

deduction from net utility plant for CIAC should be based on that levels of Access Fees allocated by Staff witness Sant to water and sewer operations, respectively.

Staff notes in its Brief (p. 2) that the purchase prices for the water system and sewer system, respectively, are each \$100. No witness in this proceeding, however, proposed that the net original cost of either the water system or the sewer system should be based on the purchase price paid by CIWC. Moreover, as discussed in CIWC's Initial Brief (p. 20), the Commission has recognized in past orders that, when a small water system property is acquired for a purchase price below original cost, the full original cost of property at the time it was first devoted to public service should be recognized in rate base. Rollins Sewer and Water Company, Docket 83-0693 (Oct. 30, 1984); Accounting Instruction 18(A) of USOA-Water. This is particularly true in circumstances where a failure to recognize the full original cost would result in a remaining rate base which is either low or a negative amount. The Commission has determined that, in such circumstances, it is necessary to recognize the full original cost of property acquired in order to provide a proper incentive for acquisitions, such as the one in the present case, which are in the public interest. The evidence discussed in CIWC's Initial Brief (pp. 4-9) demonstrates that the Acquisition is of the type which should be encouraged. As the Commission stated in Rollins Sewer and Water Company, Docket 83-0693, a failure to recognize the original cost of property as first devoted to public service would raise "yet another disincentive or impediment" to the acquisition of a small water system. The Commission also recognized this point in Consumers Illinois Water Company, Docket 88-0045 (Oct. 12, 1988). Staff's reference to the purchase price should, therefore, be disregarded.

II. NET ORIGINAL COST

Staff's Brief (pp. 6-13) demonstrates a significant misunderstanding of the issues related to determination of water and sewer net original cost. Part of the confusion results from Staff's failure to fully distinguish matters at issue with regard to water original cost from those affecting only the sewer original cost determination. In this Reply Brief, CIWC will first address the issues related to water net original cost and, thereafter, those related to sewer net original cost.

A. WATER NET ORIGINAL COST

According to Staff (Br., pp. 11-12), CIWC's position with regard to water original cost is, "... that Thorngate's records do not provide a precise figure and cost estimates should instead be substituted ..." Staff (Br., pp. 7-8) further attributes to CIWC the view that, "... in addition to Thorngate's cost of obtaining the water system, the residential development's system construction costs must also be considered ..." None of these statements, however, accurately characterize either CIWC's position or the dispute between CIWC and Staff with regard to water original cost.

At the time that Mr. Sant's Direct Testimony was filed, Mr. Sant believed that Thorngate's unexplained accounting entries (the numbers shown on Staff Ex. 1.0, Sch. 3) reflected both water and sewer system costs. [Staff Ex. 1.0, pp. 6-7; Tr. 42.] Mr. Sant, however, no longer holds this view. As pointed out in CIWC's Initial Brief (p. 13), CIWC and Staff now agree that no costs for construction of the water system are included in the accounting entries. [CIWC Ex. 1.0R, pp. 3-6 (Rakocy); CIWC Ex. 2.0R, p. 4 (Ackman); Tr. 42 (Sant).]

CIWC and Staff also agree that what the records do show is that Thorngate entered into contracts with the Phase 2 developers under which it exchanged 38 acres of land for cash, construction of the water system and other infrastructure items. [CIWC Ex. 1.0SR, p. 5 (Rakocy); Staff Ex. 3.0, p. 6 (Sant).] As stated by Staff in its Brief (p. 12), "CIWC correctly

represents that the Water System was not contributed to Thorngate; real estate exchanged paid for the Water System." Thus, CIWC and Staff are in full agreement that Thorngate paid for the water system with land, i.e., "consideration other than cash."

The disagreement between CIWC and Staff is over the effect of this form of payment on determination of the water system's cost. CIWC maintains that Accounting Instruction 18 of the USOA-Water, which is discussed in the record of this proceeding (Tr. 36-38; CIWC Cross-Exam. Ex. 1) and in CIWC's Initial Brief (pp. 11-15), but not mentioned at all by Staff, establishes the approach which should be used when the consideration given in return for utility property is other than cash.

Specifically, Accounting Instruction 18(B) of the USOA-Water states as follows:

When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis (emphasis added).

[CIWC Cross-Exam. Ex. 1, p. 1.] This principle is confirmed by the last sentence of Accounting Instruction 18(A) which indicates that, as used in the plant accounts, the term "cost" has the meaning stated in Definition 9 of the USOA-Water. [CIWC Cross-Exam. Ex. 1, p. 1.] Definition 9 also indicates that the value of consideration "other than cash" which is provided in exchange for utility plant constitutes the "cost" of the acquired plant. [CIWC Cross-Exam. Ex. 1, p. 2.] Thus, as Mr. Rakocy indicated, the original cost of the water system is equivalent to the value of the portion of the 38 acres of land which Thorngate transferred to the Phase 2 developers in return for the water system. [CIWC Ex. 1.0SR, p.p. 6,8.]

Contrary to the representation in Staff's Brief (p. 7), CIWC does not maintain that the cost incurred in constructing the water system should be considered "in addition to Thorngate's cost of obtaining the Water System." Rather, as is fully explained in CIWC's Initial Brief (pp. 14-15), CIWC believes that the cost incurred by the Phase 2 developers to construct the

water system is a reasonable estimate of the value of the land exchanged by Thorngate for the system. [CIWC Ex. 1.0SR, p. 8.] In other words, the cost incurred for construction represents the "value" of the consideration provided by Thorngate for the water system (CIWC Ex. 1.0SR, p. 8), it is not "in addition to Thorngate's cost."

In its Brief (pp. 12-13), Staff repeats its assertion that, because the value of Thorngate's land had increased at the time of the exchange to a level above the cost incurred by Thorngate to acquire it, "Staff calculates Thorngate's Water System investment at zero." Accounting Instruction 18 and Definition 9 of the USOA-Water, however, make clear that, where non-cash consideration is exchanged for utility plant, the "cost" of the acquired utility plant is equivalent to the "value" of the property exchanged. [CIWC Cross-Exam Exhibit 1, pp. 1-2; Accounting Instruction 18(A) and (B); Def'n No. 9, USOA-Water.] The USOA does not indicate that the original cost of acquired utility plant is equal to the cost of exchanged property, irrespective of its value at the time of the exchange. [CIWC Cross-Exam Exhibit 1] Indeed, such a provision would defy logic and common sense.

Contrary to the position taken by Staff (Br., pp. 12-13), Thorngate paid for the water system, not with the "cost of its land exchanged" but with the value of its land exchanged. [CIWC Ex. 1.0SR, p. 6.] In the transaction, the value of Thorngate's 38 acres of land was equivalent to the sum of: (i) the amount of cash received by Thorngate; and (ii) the value of the water system and other infrastructure which the Phase 2 developers agreed to construct. [Id., p. 7.] As Mr. Rakocy explained, Mr. Sant's suggestion that the value of the land should be reduced by the amount of cash received is illogical. There is no basis to subtract the amount of cash received in determining the value of Thorngate's payment to the Phase 2 developers. [Id.] Contrary to the position of Mr. Sant, the fact that the value of the land at the time of the

exchange for the water system exceeded its cost does not suggest that Thorngate somehow had no investment in the water system. [Id., p. 7.] As discussed in CIWC's Initial Brief (pp. 14-15), even Mr. Sant ultimately recognized that, under the USOA, the value of non-cash consideration provided in return for utility plant is the pertinent amount. [Tr. 39.]

CIWC's evidence regarding the value of the exchanged land was uncontested either in the record or in Staff's Brief. Staff's witness, Mr. Sant, admitted that he has no information at all about the land's value. [Tr. 36.] Thus, CIWC's evidence regarding the value of the consideration provided by Thorngate in return for the land is reasonable and should be accepted.

Contrary to the position taken by Staff in its Brief (pp. 7-8), CIWC's proposal is not inconsistent with the Order in Killarney Water Company, Docket 51165 ("Killarney Order"). With regard to Staff's comments (Br., pp. 7-8), we would first note that the fact situation referenced by Staff (Br., pp. 7-8) from the Killarney Order is one of three which the Commission indicated it had observed, but is not the situation addressed in the Killarney Order itself. [Killarney Order, p. 3] Moreover, the language of the Killarney Order quoted by Staff (Br., p. 8) says only that the cost to be considered in determining net original cost is the "cost to the purchaser" of the system and not that of the builder (emphasis in original). Staff (Br., p. 8) goes on to indicate that, in this case, the purchaser is Thorngate. CIWC agrees with these statements. In the context of this case, however, the purchaser's cost (as referenced in the Killarney Order), is the value of the property provided by the purchaser (i.e., Thorngate) in return for the water system, which is the value of the exchanged land. [CIWC Ex. 1.0SR, p. 6.] Furthermore, the costs incurred by the Phase 2 developers to build the water system are, for the reasons discussed above and in CIWC's Initial Brief, a measure of Thorngate's cost to acquire the system by exchanging its land. The language quoted from the Killarney Order does not address a situation

of this type and the Killarney Order does not suggest that the estimated cost of the water system cannot be considered as an estimate of the value of property exchanged for the water system.

In its Initial Brief (p. 3), Staff refers to the estimated costs developed by "CIWC" for the water and sewer systems as "subjective." Neither CIWC's estimation procedure nor its results, however, are contested in the record. As shown in Exhibit H (Revised), the estimated net utility plant for the water system is \$1,368,483. [CIWC Ex. 1.0SR, p.8.]. Mr. Rakocy's uncontested testimony indicates that this amount, "is the best available evidence of the original cost of the water system at the time that it was first devoted to public service." [Id.] Furthermore, it is uncontested that this amount is also the best available evidence of the value of the land exchanged by Thorngate for construction of the water system. [CIWC Ex. 1.0SR, p. 8.] Based on this data and the level of CIAC agreed to by CIWC and Staff, the net original cost for the water system proposed by CIWC and reflected in CIWC Exhibit 1.3SR is as follows:

Description (A)	Per Company
Utility Plant in Service	\$1,624,987
Less: Accumulated Depreciation	<u>(264,504)</u>
Net Utility Plant-in-Service	1,368,483
Deduct:	
Contributions in Aid of Construction	<u>(483,840)</u>
Net Original Cost Plant:	<u>\$884,643</u>

B. Sewer Original Cost

1. Company Proposal

In its Brief (p. 10), Staff defends its proposal to adopt as original cost for the sewer system amounts recorded in the two accounts listed on Staff Ex. 1.0, Sch. 3. Staff maintains (Br. p. 10) that the amounts reflected in these accounts reflect "the total dollar amount invested

in Sewer System capital assets.” In support of this statement, however, Staff cites only Staff Ex. 1.0, Schedule 3, which provides no information at all about the items included in the two accounts. [Staff Ex. 1.0, Sch. 3; CIWC Ex. 1.0AS, p. 3.] Furthermore, Staff’s assertion that the two accounts reflect all of the capitalized sewer system investment flies in the face of the testimony of Mr. Ackman, Thorngate’s General Manager and Chief Operating Officer, who testified expressly that this was not the case. [Tr. 66-67, 73-75.] Unfortunately for Staff, its failure to discuss Mr. Ackman’s testimony in its Brief cannot make the testimony go away.

Contrary to the assertion in Staff’s Brief (p. 9), CIWC’s concern with Thorngate’s accounting entries has nothing to do with whether the entries are audited or sufficient for Thorngate’s purposes. Nor does CIWC maintain that Thorngate was required to maintain its accounts in accordance with the USOA, as Staff also suggests (Br., p. 11). As Mr. Rakocy explained, the problem with Thorngate’s accounts, audited or not, is that the accounts do not provide complete or clear information regarding the original cost of the sewer facilities. [CIWC Ex. 1.0R, p. 3.] Thorngate is not now nor has it ever been a regulated entity or public corporation and, for this reason, does not keep its books in accordance with the USOA and has not maintained separate accounts for the water or sewer systems. [Id.] All of Thorngate’s accounting entries associated with the water and sewer systems are contained within the books and records of Thorngate’s country club operation. There are no separate accounts. [Id.; CIWC Ex. 2.0R, p. 4.] Thus, as Mr. Ackman indicated, water and sewer utility-related costs are sometimes recorded in accounts other than those shown as Schedule 3, such as the account for country club “grounds and greens.” [Tr. 66-67, 73-75.]

As explained in CIWC’s Initial Brief (pp. 18-21, 25) and as the record shows, it is not possible to determine what the accounting entries shown on Schedule 3 represent. Furthermore,

although not acknowledged by Staff in its Brief, the lack of available accounting information is undisputed in the record:

Mr. Rakocy: "... the components of the sewer plant covered by the accounting records [Schedule 3] cannot be determined from Thorngate's account records."
[CIWC Ex. 1.0AS, p. 3.]

Mr. Sant (responding to a question on cross-examination):

Q: Aside from Schedule 3, you have no accounting records, studies, work papers, analyses or any other documents indicating the content of the two accounts shown, is that correct?

A: That is correct. [Tr. 42.]

It is also undisputed that, when the available accounting records are inadequate to determine the original cost of acquired property, Accounting Instruction 17(C) of the USOA-Water requires that an estimate be developed. [CIWC Ex. 1.0R, p. 3 (Rakocy); Tr. 39 (Sant).] Accordingly, as in the case of the water system, CIWC performed a survey of the Ivanhoe system and developed an estimate of the present-day cost of the system. [CIWC ex. 1.0R, p. 2.] As discussed above, CIWC trended the estimated present-day costs back to the approximate date of construction to determine an estimated original cost, net of depreciation. [Id.] As Mr. Rakocy indicated, CIWC also estimated a level of customer contributed plant. [Id., p. 3.]

As shown on CIWC Exhibit "H (Revised)," page 2, the level of sewer utility Plant-in-Service estimated by CIWC is \$2,795,805, and applicable depreciation is \$649,329. Thus, the original cost of Utility Plant-in-Service, net of depreciation is \$2,146,477. [CIWC Ex. H (Rev.), p. 2.] As in the case of the water system, CIWC accepted Staff's proposal to adopt as the appropriate level of CIAC an allocation of the total balance of Access Fees which Thorngate will ultimately receive (in lieu of the balance of CIAC which CIWC had estimated).

[CIWC Ex. 1.0SR, p. 12, 1.0AS, p. 4.] Thus, net original cost for sewer operations based on the estimated original cost developed by CIWC (using Staff's proposed level of CIAC) is as follows:

Sewer Net Original Cost

Utility Plant-in-Service	\$2,795,805
Less: Accumulated Depreciation	(649,328)
Net Utility Plant-in-Service	2,146,477
Deduct:	
Contributed Plant in Aid of Construction	<u>(596,160)</u>
Net Original Cost Plant	<u>\$1,550,317</u>

2. Alternative Proposal

As Staff recognizes in its Brief (p. 10), CIWC indicated that, as an alternative to the above calculation, it would accept the level of net original cost developed by Staff for sewer operations; provided that Staff's proposed level of Utility Plant-in-Service is adjusted to include contributed plant. [CIWC Ex. 1.0AS, p. 4.] When adjusted to include contributed plant in the amount of \$596,160, the level of Plant-in-Service determined from Thorngate's accounting records is \$2,874,085, which compares favorably to CIWC's estimated Plant-in-Service balance of \$2,795,805. [CIWC Ex. 1.0AS, p. 4.]

For this reason, as Mr. Rakocy indicated, CIWC would accept the adjusted Staff result based on Thorngate's records, detailed as follows on CIWC Exhibit 1.3SR:

Description (A)	Per <u>Company</u>
Utility Plant-in-Service	\$2,874,085
Less: Accumulated Depreciation	<u>(1,179,310)</u>
Net Utility Plant-in-Service	1,694,775
Deduct:	
Contributions in Aid of Construction	<u>(596,160)</u>
Net Original Cost Plant:	<u>\$1,098,615</u>

In his Direct Testimony and Exhibits, Staff witness Sant included as an element of Plant-in-Service Staff's calculation of the cost of contributed plant. [Staff Ex. 1.0, Sch. 4; CIWC Ex. 1.0AS, p. 2.] As Mr. Rakocy explained, this approach is appropriate because, under the USOA and in rate cases, the balance of contributed plant is included in Plant-in-Service and then deducted from rate base as a separate line item. [CIWC Ex. 1.0AS, p. 2.] As explained in CIWC's Initial Brief (pp. 23-26), however, Staff later submitted Rebuttal and Supplemental Rebuttal evidence in which the cost of contributed plant is excluded from plant-in-service, but then deducted as a separate line item from the plant-in-service balance.

As indicated in Mr. Sant's Supplemental Rebuttal evidence (Staff Ex. 5.0, pp. 4-5) and in Staff's Brief (p. 11), the sole basis for Mr. Sant's proposal to exclude the cost of contributed plant from plant-in-service is a belief that all sewer system construction costs are reflected in the two accounts shown on Schedule 3. [Staff Ex. 5.0, pp. 4-5.] The record, however, demonstrates that this is not the case.

In this regard, CIWC and Staff agree that all of the available information from Thorngate's accounting records is set forth on Mr. Sant's Schedule 3. [CIWC Ex. 1.0AS, p. 3]

(Rakocy); Tr. 42 (Sant).] As explained above, however, CIWC and Staff also agree that there is no information with regard to the content of the two accounts shown on the Schedule. [CIWC Ex. 1.0AS, p. 3 (Rakocy); Tr. 42 (Sant).] As Mr. Rakocy indicated, if the cost of contributed plant is excluded from Mr. Sant's calculation of Plant-in-Service, there is a significant discrepancy between Mr. Sant's sewer Plant-in-Service result based on Schedule 3, \$2,277,925 (Schedule 7, Revised)), and the estimated original cost of the entire sewer plant as surveyed by CIWC, \$2,874,085. [CIWC Ex. 1.0AS, p. 2.] Staff offers nothing in its evidence or its Brief to explain why Thorngate's cost records should vary to this extent from the results of the survey and estimate. Furthermore, as indicated above, Staff completely fails to note that Mr. Ackman testified expressly that capitalized sewer system costs are recorded in accounts other than those shown on Schedule 3, such as the country club account for grounds and greens. (emphasis added) [Tr. 66-67, 73-75.] Mr. Ackman's undisputed testimony establishes that a reason for the discrepancy between the cost data shown on Mr. Sant's Schedule 3 and the cost estimate developed by CIWC is that the Schedule 3 data doesn't reflect the cost of the entire sewer plant. As Mr. Ackman expressly indicated, sewer plant costs are recorded by Thorngate not only in the two accounts shown on Schedule 3, but also in other country club accounts. [Tr. 66-67, 73-75.] Thus, Staff's position that the two Schedule 3 accounts reflect all capitalized sewer costs is wholly unsupported by the record.

Under the circumstances of this case, CIWC submits that the original cost of the acquired sewer utility plant cannot be "known" on the basis of Thorngate's records. For this reason, Accounting Instruction 17(c) of the USOA-Sewer requires that an estimate of original cost be developed. [CIWC Ex. 1. OR, p. 3 (Rakocy); Tr. 39 (Sant).] The Commission should adopt as the appropriate level of sewer original cost either the cost data from CIWC Exhibit H (Revised)

as set forth at pages 9-10 above or the alternative proposal based on an adjustment of Mr. Sant's data as set forth at page 11 above which CIWC has indicated that it will accept

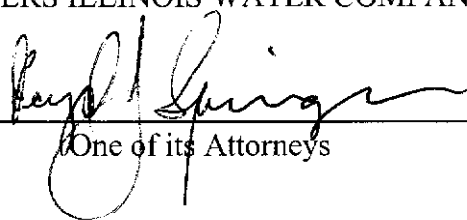
III. CONCLUSION

For the reasons discussed above and in the Company's Initial Brief, the water and sewer net original cost data proposed by CIWC should be accepted.

Respectfully submitted,

CONSUMERS ILLINOIS WATER COMPANY

By: _____

A handwritten signature in dark ink, appearing to read "Boyd J. Springer", is written over a horizontal line. Below the line, the text "One of its Attorneys" is printed.

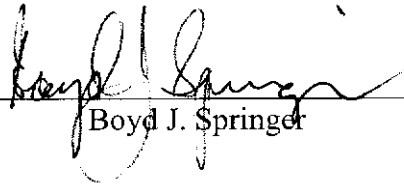
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Dated: January 16, 2001

CERTIFICATE OF SERVICE

Boyd J. Springer, an attorney, hereby certifies that he served a copy of the Reply Brief and Proposed Order of Consumers Illinois Water Company on the individuals shown on the attached Service List via Federal Express overnight delivery on Tuesday, January 16, 2001.



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